

**Letter of Findings: 08-0622
Sales and Use Tax
For the Year 2007**

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ISSUES

I. Sales and Use Tax – Imposition.

Authority: IC § 6-8.1-5-1; IC § 6-2.5-1-1 et seq; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-5-8; IC § 6-6-6.5-8(d); [45 IAC 2.2-5-15](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax. Ct. 2007); Rotation Products Corp. v. Dep't of State Revenue, 690 N.E.2d 795 (Ind. Tax Ct. 1998).

Taxpayer protests the imposition of use tax on an aircraft.

II. Tax Administration – Imposition of Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of the ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer, a single member LLC in Indiana, purchased a new aircraft for \$3,700,000 on September 24, 2007. Taxpayer did not pay sales tax on the purchase, claiming it is entitled to an exemption because it is in the business of renting or leasing this aircraft to others. On September 25, 2007, Taxpayer executed an Aircraft Hourly Rental Agreement. Subsequently, Taxpayer registered this aircraft in Indiana and claimed its exemption from use tax. The Indiana Department of Revenue ("Department") reviewed Taxpayer's application, disallowed the exemption, and assessed use tax, interest, and penalty on use of the aircraft in Indiana. Taxpayer protested the Department's assessment and negligence penalty. A hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary.

I. Sales and Use Tax – Imposition.

DISCUSSION

All tax assessments are prima facie evidence that the Department's claim for the tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

On initial review, the Department found that Taxpayer purchased an aircraft without paying sales tax at the time of purchase, and assessed use tax on the aircraft.

IC § 6-2.5-2-1 provides:

(a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.

(b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

IC § 6-2.5-3-2(a) provides:

An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

Accordingly, Indiana imposes a sales tax on retail transactions and a complementary use tax on tangible personal property that is stored, used, or consumed in the state. IC § 6-2.5-1-1 et seq. An exemption from the use tax is granted for transactions where the gross retail tax ("sales tax") was paid at the time of purchase pursuant to IC § 6-2.5-3-4.

Additionally, IC § 6-6-6.5-8(d) provides for the payment of sales or use tax on an aircraft, as follows:

A person shall pay the gross retail tax or use tax to the department on the earlier of:

- (1) The time the aircraft is registered; or
- (2) not later than thirty-one (31) days after the purchase date;

unless the person presents proof to the department that the gross retail tax or use tax has already been paid with respect to the purchase of the aircraft or proof that the taxes are inapplicable because of an exemption.

In the present case, Taxpayer claimed that its use of the aircraft qualified for an exemption and, therefore, Taxpayer did not pay the sales tax at the time of purchase. Taxpayer argued that its purchase of this aircraft meets the rental to others exemption pursuant to IC § 6-2.5-5-8(b).

IC § 6-2.5-5-8(b) states:

Transactions involving tangible personal property other than a new motor vehicle are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of his business without changing the form of the property.

[45 IAC 2.2-5-15](#) further explains, as follows:

(a) The state gross retail tax shall not apply to sales of any tangible personal property to a purchaser who purchases the same for the purpose of reselling, renting or leasing, in the regular course of the purchaser's business, such tangible personal property in the form in which it is sold to such purchaser.

(b) General rule. Sales of tangible personal property for resale, rental or leasing are exempt from tax if all of the following conditions are satisfied:

(1) The tangible personal property is sold to a purchaser who purchases this property to resell, rent or lease it;

(2) The purchaser is occupationally engaged in reselling, renting or leasing such property in the regular course of his business; and

(3) The property is resold, rented or leased in the same form in which it was purchased.

(c) Application of general rule.

(1) The tangible personal property must be sold to a purchaser who makes the purchase with the intention of reselling, renting or leasing the property. This exemption does not apply to purchasers who intend to consume or use the property or add value to the property through the rendition of services or performance of work with respect to such property.

(2) The purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. Occasional sales and sales by servicemen in the course of rendering services shall be conclusive evidence that the purchaser is not occupationally engaged in reselling the purchased property in the regular course of his business.

(3) The property must be resold, rented or leased in the same form in which it was purchased.

Tax exemptions generally are strictly construed against taxpayers. *Rotation Products Corp. v. Dep't of State Revenue*, 690 N.E.2d 795, 798 (Ind. Tax Ct. 1998). When a taxpayer claims that it is entitled to a tax exemption, it bears the burden of proving its entitlement to the exemption. *Id.* Here, Taxpayer claims its entitlement to an exemption and, therefore, Taxpayer bears the burden of proving its eligibility.

In this instance, Taxpayer's aircraft is properly titled, registered, and insured. Soon after Taxpayer purchased the aircraft, Taxpayer executed an Aircraft Hourly Rental Agreement ("Rental Agreement"). However, the Rental Agreement is the only rental agreement Taxpayer has contracted, and the rental fees collected from this Rental Agreement have been the only revenue Taxpayer generates since Taxpayer established its business. Both the lessee and Taxpayer agreed to the rental charge of \$625 per hour for use of the aircraft.

Taxpayer argued that Taxpayer's \$625 hourly charge is reasonable. Taxpayer stated that it could not find another identical aircraft, N744DA, available for rental and leasing in the current market in order to compare rates. Taxpayer claimed that its aircraft is unique. Therefore, Taxpayer proposed and offered a Cirrus SR22 aircraft as a comparison, and concluded that its rate is reasonable as compared to the rental charge of a Cirrus SR22 aircraft. Taxpayer stated that the retail price of a new Cirrus SR22 approximately is \$600,000 and can be rented for probably \$100 - \$125 per hour. Documentation shows that the purchase price of Taxpayer's aircraft is \$3,700,000. It is about six (6) times of a Cirrus SR22 in value. Taxpayer charges \$625 per hour for renting Taxpayer's aircraft. Taxpayer's rental charge is also about six (6) times of a Cirrus SR22's rental charge. Thus, Taxpayer argued that its \$625 hourly charge is reasonable. Business generally would expect its business to be profitable. In the present case, Taxpayer spent 3.7 million dollars purchasing this aircraft for its rental and leasing business. However, Taxpayer does not make itself known to the public that it is renting and leasing this aircraft. Taxpayer does not advertise its rental and lease business, nor does it provide any promotions to attract more perspective customers. Assuming Taxpayer's rental charge is reasonable, the only revenue Taxpayer generated is from this Rental Agreement. Coincidentally, the sole member of Taxpayer is also the president of the lessee to the Rental Agreement. It raises the question whether Taxpayer is occupationally engaged in renting or leasing this aircraft in the regular course of his business.

IC § 6-2.5-5-8(e) provides, as follows:

This subsection applies only after June 30, 2008. A transaction in which a person acquires an aircraft for rental or leasing in the ordinary course of the person's business is not exempt from the state gross retail tax unless the person establishes, under guidelines adopted by the department in the manner provided in [IC 4-22-2-37.1](#) for the adoption of emergency rules, that the annual amount of the lease revenue derived from leasing the aircraft is equal to or greater than:

(1) ten percent (10 [percent]) of the greater of the original cost or the book value of the aircraft, if the original cost of the aircraft was less than one million dollars (\$1,000,000); or

(2) seven and five-tenths percent (7.5 [percent]) of the greater of the original cost or the book value of the aircraft, if the original cost of the aircraft was at least one million dollars (\$1,000,000).

While this statute was not yet in effect for a 2007 aircraft purchase, it is a useful guide of what constitutes reasonable annual rental revenues for a person occupationally engaged in renting or leasing an aircraft. Here, the purchase price of Taxpayer's aircraft was \$3,700,000. As provided by IC § 6-2.5-5-8(e)(2), after June 30, 2008, the annual amount of lease revenue that Taxpayer derives from the leasing of the aircraft would need to be equal or greater than seven and five-tenths (7.5) percent of the original cost or the book value of the aircraft, if the

original cost of the aircraft was at least one million dollars (\$1,000,000), in order for Taxpayer to qualify for the exemption; i.e., a minimum of \$277,500. Thus, Taxpayer would have needed to generate \$69,375 in sales for 2007 and \$277,500 in sales for 2008 to qualify for the sales tax exemption on the purchase of the aircraft. Taxpayer generated \$11,462.50 in sales in 2007 and \$69,262.50 in sales in 2008, less than twenty-five (25) percent of that required threshold. Therefore, based upon the evidence presented, the Department is unable to conclude that Taxpayer is "occupationally engaged in reselling, renting, or leasing such property in the regular course of his business." [45 IAC 2.2-5-15](#)(b)(2). Thus, Taxpayer has not met the burden imposed by IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is respectfully denied.

II. Tax Administration – Imposition of Negligence Penalty.

DISCUSSION

Taxpayer also protests the assessment of the negligence penalty.

Pursuant to IC § 6-8.1-10-2.1, the Department may assess a ten (10) percent negligence penalty if the taxpayer:

- (1) fails to file a tax return;
- (2) fails to pay the full amount of tax shown on the tax return;
- (3) fails to remit in a timely manner the tax held in trust for Indiana (e.g., a sales tax); or
- (4) fails to pay a tax deficiency determined by the Department to be owed by a taxpayer.

[45 IAC 15-11-2](#)(b) further states:

"Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The Department may waive a negligence penalty as provided in [45 IAC 15-11-2](#)(c), in part, as follows:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Taxpayer has demonstrated that it had reasonable cause to believe that it is entitled to the exemption. Thus, Taxpayer's protest on the imposition of negligence penalty is sustained.

FINDING

Taxpayer's protest on imposition of negligence penalty is sustained.

SUMMARY

For the reasons discussed above, Taxpayer's protest on imposition of use tax is respectfully denied. Taxpayer's protest on imposition of negligence penalty is sustained.

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